

1 TIMOTHY A. MILLER (SBN 154744)

**VALLE MAKOFF LLP**

2 255 Shoreline Drive, Suite 550

3 Redwood City, CA 94065

4 Telephone: (650) 966-5113

5 Facsimile: (650) 240-0485

Email: tmiller@vallemakoff.com

6 AVI B. ISRAELI (*pro hac vice*)

7 KAREN A. SEBASKI (*pro hac vice*)

**HOLWELL SHUSTER & GOLDBERG LLP**

8 425 Lexington Avenue

9 New York, NY 10017

10 Telephone: (646) 837-5151

11 Facsimile: (646) 837-5150

12 Email: aisraeli@hsgllp.com

13 Email: ksebaski@hsgllp.com

14 Attorneys for Interested Party

15 Progresso Ventures, LLC

16 UNITED STATES DISTRICT COURT  
17 NORTHERN DISTRICT OF CALIFORNIA  
18 SAN FRANCISCO DIVISION

19 SECURITIES AND EXCHANGE COMMISSION,

20 Plaintiff,

21 v.

22 JOHN V. BIVONA; SADDLE RIVER  
23 ADVISORS, LLC; SRA MANAGEMENT  
24 ASSOCIATES, LLC; FRANK GREGORY  
25 MAZZOLA,

26 Defendants, and

27 SRA I LLC; SRA II LLC; SRA III LLC;  
28 FELIX INVESTMENTS, LLC; MICHELE  
J. MAZZOLA; ANNE BIVONA; CLEAR  
SAILING GROUP IV LLC; CLEAR  
SAILING GROUP V LLC,

Relief Defendants.

Case No. 3:16-cv-01386-EMC

**INTERESTED PARTY PROGRESSO  
VENTURES, LLC'S SUPPLEMENTAL  
BRIEF RE: CLASSIFICATION OF ITS  
INVESTOR AND CREDITOR CLAIMS  
(PER D.E. 379)**

Date: August 16, 2018

Time: 1:30 pm

Courtroom: 5

Judge: Edward M. Chen

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25  
26  
27  
28

**TABLE OF CONTENTS**

SUPPLEMENTAL MEMORANDUM OF POINTS AND AUTHORITIES..... 1

I. The general rule is that creditors take priority over investors; there is no basis to set a different priority here. *Re Question 1.* ..... 1

II. Progresso’s New York judgment is entitled to full faith and credit, and the Court may not ignore or reduce portions of it. *Re Question 2.* ..... 3

III. Progresso can and should be allowed to choose between creditor and investor status, in keeping with the rights it brought into these proceedings. *Re Question 3.* ..... 3

**TABLE OF AUTHORITIES**

**Cases**

1

2

3 *CFTC v. Lake Shore Asset Mgmt. Ltd.*,  
646 F.3d 401 (7th Cir. 2011) ..... 1

4

5 *CFTC v. RFF GP*,  
2014 WL 491639 (E.D. Tex. Feb. 4, 2014)..... 2

6 *Codwise v. Gelston*,  
1812 WL 976 (N.Y. 1812) ..... 3, 6

7

8 *FTC v. Network Servs. Depot, Inc.*,  
617 F.3d 1127 (9th Cir. 2010) ..... 5

9

10 *Gaff v. Fed. Deposit Ins. Corp.*,  
919 F.2d 384 (6th Cir. 1990) ..... 1

11 *Gonzalez v. Axess Trade Co. Inc.*,  
2005 WL 1384019 (S.D.N.Y. June 9, 2005) ..... 1

12

13 *Harris Tr. & Sav. Bank v. Salomon Smith Barney, Inc.*,  
530 U.S. 238 (2000) ..... 5

14

15 *In re Am. Wagering, Inc.*,  
493 F.3d 1067 (9th Cir. 2007) ..... 2

16 *In Re CWS Enters., Inc.*,  
870 F.3d 1106 (9th Cir. 2017) ..... 3

17

18 *In re Ferrara*,  
510 F. App'x 575 (9th Cir. 2013)..... 3

19 *In re Frontier Props., Inc.*,  
979 F.2d 1358 (9th Cir. 1992) ..... 3

20

21 *In re N. Am. Coin & Currency, Ltd.*,  
767 F.2d 1573 (9th Cir.), amended, 774 F.2d 1390 (9th Cir. 1985) ..... 6

22

23 *In re Wyatt*,  
6 B.R. 947 (E.D.N.Y. Bankr. 1980) ..... 5

24 *Moore v. Crawford*,  
130 U.S. 122 (1889) ..... 5

25

26 *Morris v. Jones*,  
329 U.S. 545 (1947) ..... 3

27

28

1	<i>Nickel v. Bank of Am. Nat'l Tr. &amp; Sav. Ass'n,</i>	
2	290 F.3d 1134 (9th Cir. 2002).....	4
3	<i>Provencher v. Berman,</i>	
4	699 F.2d 568 (1st Cir. 1983) .....	6
5	<i>Republic Supply Co. of Cal. v. Richfield Oil Co. of Cal.,</i>	
6	79 F.2d 375 (9th Cir. 1935).....	2
7	<i>Riehle v. Margolies,</i>	
8	279 U.S. 218 (1929) .....	3
9	<i>Scully v. Pac. States Sav. &amp; Loan Co.,</i>	
10	88 F.2d 384 (9th Cir. 1937).....	2
11	<i>SEC v. Colello,</i>	
12	139 F.3d 674 (9th Cir. 1998).....	5
13	<i>SEC v. Enter. Tr. Co.,</i>	
14	559 F.3d 649 (7th Cir. 2009).....	1
15	<i>SEC v. Total Wealth Mgmt., Inc.,</i>	
16	2018 WL 3456007 (S.D. Cal. July 18, 2018).....	1
17	<i>SEC v. United Fin. Grp., Inc.,</i>	
18	576 F.2d 217 (9th Cir. 1978).....	3
19	<i>SEC v. Vassallo,</i>	
20	2011 WL 3875640 (E.D. Cal. Sept. 1, 2011).....	5
21	<i>SEC v. Wealth Mgmt. LLC,</i>	
22	2009 WL 10699977 (E.D. Wis. Nov. 20, 2009).....	1
23	<i>SEC v. Wealth Mgmt. LLC,</i>	
24	628 F.3d 323 (7th Cir. 2010).....	1
25	<i>SEC v. Wencke,</i>	
26	783 F.2d 829 (9th Cir. 1986).....	5
27	<i>United States v. Pegg,</i>	
28	782 F.2d 1498 (9th Cir. 1986).....	2
	<b><u>Statutes</u></b>	
	11 U.S.C. § 510(b).....	2
	28 U.S.C. § 1738 .....	3

1 **Other Authorities**

2 Bogert, The Law of Trusts and Trustees § 867 ..... 4  
3 Clark on Receivers § 851 (1918)..... 2  
4 Clark on Receivers § 860 (1918)..... 1  
5 Restatement (Second) of Conflict of Laws § 417 (1971)..... 3  
6 Restatement (Third) of Restitution and Unjust Enrichment § 51 (2011)..... 4  
7 Wright & Miller, Fed. Prac. & Proc. § 4469 (2d ed.)..... 3  
8 15 Cyc. of Federal Proc. § 76:12 (3d ed.) ..... 2  
9

10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25  
26  
27  
28



1 *Total Wealth Mgmt., Inc.*, 2018 WL 3456007, at \*5 (S.D. Cal. July 18, 2018) (collecting cases).  
 2 The Code’s priority scheme, in turn, “serves to effectuate one of the general principles of corporate  
 3 and bankruptcy law: that creditors are entitled to be paid ahead of shareholders in the distribution of  
 4 corporate assets.” *In re Am. Wagering, Inc.*, 493 F.3d 1067, 1071 (9th Cir. 2007). Under that  
 5 scheme, Progresso would be given priority. 11 U.S.C. § 510(b); *see, e.g., In re Am. Wagering, Inc.*,  
 6 493 F.3d at 1071. It should be treated no worse in receivership.

7 Indeed, to the extent Progresso may be considered a *secured* creditor, the Court would have  
 8 no discretion, but would be required to give Progresso priority. *See Clark, supra*, § 851 (“The legal  
 9 priority will be protected and preserved in chancery.”). Here, Progresso is analogous to a secured  
 10 creditor by virtue of its judgment, regardless of whether it met the technical legal requirements for a  
 11 pre-receivership judgment lien. Treating Progresso’s judgment as an equitable lien would be fair,  
 12 since otherwise its rights would be defeated by the fortuity that it obtained a judgment just a few  
 13 months after the receiver’s appointment, rather than a few months earlier. *See United States v.*  
 14 *Pegg*, 782 F.2d 1498, 1501 (9th Cir. 1986) (“[E]quity will disregard mere form and will ascertain  
 15 and act on the substance of things.”). That would be especially unfair given that Bivona and  
 16 Mazzola’s ongoing fraud and hollow promises to repay caused the delay. And apart from any lien  
 17 arising from its judgment, courts have also recognized liens arising (1) from the filing of a  
 18 complaint, or even (2) from the act of misappropriation itself. Either would give Progresso secured,  
 19 priority status here.<sup>3</sup>

20 But regardless of whether its claim is secured or not, Progresso is a creditor and should be  
 21 given priority over investors, in keeping with general equitable principles of insolvency law.<sup>4</sup>

22  
 23 <sup>3</sup> *See* 15 Cyc. of Federal Proc. § 76:12 (3d ed.) (“The filing of a creditor’s action and the service of  
 24 process create a lien on the specific property sought to be reached, provided the complaint points  
 25 out specific property of the debtor sought to be reached.”); *Scully v. Pac. States Sav. & Loan Co.*,  
 88 F.2d 384, 387 (9th Cir. 1937) (victim of misappropriation entitled to equitable lien in  
 26 misappropriated assets); *Republic Supply Co. of Cal. v. Richfield Oil Co. of Cal.*, 79 F.2d 375, 380  
 (9th Cir. 1935) (granting “prior liens” in receivership to victim of misappropriation).

27 <sup>4</sup> Courts have sometimes prioritized investors over creditors, but there is no equitable reason to do  
 28 so here because Progresso was also the victim of fraud and its assets are included in the receivership  
 estate. *Cf. CFTC v. RFF GP*, 2014 WL 491639, at \*2 (E.D. Tex. Feb. 4, 2014) (while “not an easy  
 call,” prioritizing investors where creditor “fail[ed] to link any fraudulent conduct” to its losses).

1 **II. Progresso’s New York judgment is entitled to full faith and credit, and the Court may**  
 2 **not ignore or reduce portions of it. Re Question 2.**

3 As a matter of equity, where judgment creditors come into a receivership, “[t]he merits of  
 4 the several judgments cannot be inquired into.” *Codwise v. Gelston*, 1812 WL 976, at \*9 (N.Y.  
 5 1812). But more than just equity is at stake: Progresso’s claim is founded (in part) on its New York  
 6 judgment. As a matter of federal law, that judgment is entitled to full faith and credit in this  
 7 receivership proceeding. *See* 28 U.S.C. § 1738.<sup>5</sup> The Supreme Court has thus squarely rejected  
 8 attempts by receivers to impair state court judgments submitted as claims, even when those  
 9 judgments post-date the receiver’s appointment, holding that “the nature and amount” of a claim on  
 10 a judgment is “conclusively determined” by the judgment itself. *Morris v. Jones*, 329 U.S. 545, 545  
 11 (1947).<sup>6</sup> Bankruptcy courts are likewise required to afford full faith and credit to state court  
 12 judgments, including as to attorneys’ fees adjudged reasonable by the state court, and interest. *See,*  
 13 *e.g., In Re CWS Enters., Inc.*, 870 F.3d 1106, 1119 (9th Cir. 2017) (holding that “[t]he Full Faith  
 14 and Credit Act applies” in bankruptcy courts and upholding attorneys’ fee award in a judgment).<sup>7</sup>

15 The rule protecting Progresso’s judgment from impairment is fairly applied here. The  
 16 incurrence of fees and the non-payment of interest are part of the harm Progresso suffered, and  
 17 hence part of its claim, just as surely as the lost principal. Thus, even if the Court had discretion to  
 18 pick apart Progresso’s judgment (and it does not), there would be no equitable basis to do so here.

19 **III. Progresso can and should be allowed to choose between creditor and investor status, in**  
 20 **keeping with the rights it brought into these proceedings. Re Question 3.**

21 Progresso acknowledges that the Court has denied Progresso’s petition to pursue both its  
 22 creditor and investor claims. Although Progresso respectfully disagrees, it will not reargue the

23 <sup>5</sup> *See generally* Wright & Miller, Fed. Prac. & Proc. § 4469 (2d ed.) (federal courts must give full  
 24 faith and credit to state-court judgments); Restatement (Second) of Conflict of Laws § 417 (1971)  
 (full faith and credit applies to judgment claims in receiverships).

25 <sup>6</sup> *See also* *Riehle v. Margolies*, 279 U.S. 218 (1929); *SEC v. United Fin. Grp., Inc.*, 576 F.2d 217,  
 26 221 (9th Cir. 1978) (receivership court obligated to give full faith and credit to a state court  
 judgment for attorneys’ fees).

27 <sup>7</sup> *See also* *In re Ferrara*, 510 F. App’x 575, 575-76 (9th Cir. 2013) (upholding a claim for an  
 28 attorneys’ fee award contained in a state court judgment because the bankruptcy court was bound by  
 the preclusive effect of that judgment); *In re Frontier Props., Inc.*, 979 F.2d 1358, 1366-68 (9th Cir.  
 1992) (upholding administrative priority given to interest award included in a state court judgment).



1 point. Nevertheless, because Progresso, as a creditor whose money was wrongfully diverted into an  
 2 unauthorized investment, would ordinarily be entitled to the greater of (1) the amount it would have  
 3 received had its funds never been misappropriated (as reflected in the judgment); or (2) the  
 4 appreciation on the unauthorized investment (as reflected in the Palantir shares), it would be  
 5 inequitable to deprive it of any choice as to the nature of its remedy here.

6 ***Progresso is entitled to either recovery; it is therefore equitable to give it a choice.*** In  
 7 general, where a plaintiff’s money is misappropriated and placed into an unauthorized investment,  
 8 the plaintiff is entitled to the greater of the amount it would have received but for the  
 9 misappropriation, or the appreciation of the unauthorized investment. *Nickel v. Bank of Am. Nat’l*  
 10 *Tr. & Sav. Ass’n*, 290 F.3d 1134, 1138 (9th Cir. 2002) (“The elementary rule of restitution is that if  
 11 you take my money and make money with it, your profit belongs to me.”).<sup>8</sup> Exercising this choice  
 12 “does not involve a duplication of recovery.” Bogert, *The Law of Trusts and Trustees* § 867. Here,  
 13 Progresso’s position is consistent with these longstanding equitable principles: If the unauthorized  
 14 Palantir investment yields profits, Progresso is entitled to partake in those (as an involuntary  
 15 investor); Progresso is independently entitled to collect on its judgment (as a creditor), which Clear  
 16 Sailing prevented it from doing. Progresso’s entitlement to *either* remedy is tantamount to a choice  
 17 between them. *Id.* (“It is universally held that the beneficiary has the election of taking a money  
 18 judgment against the wrongdoing trustee or of tracing the trust property,” including appreciation on  
 19 the trust property). Even if the Court will not permit Progresso to pursue both remedies and choose  
 20 whichever is ultimately greater — though it should<sup>9</sup> — it would be inequitable to deprive Progresso  
 21 of any choice at all.

22 ***There is no legal or equitable basis to deprive Progresso of a choice between creditor and***  
 23 ***investor treatment.*** The SRA Investors argue that, to the extent Progresso had a choice between  
 24 remedies, it made that choice when it sought and obtained the New York judgment. Not so.

25 \_\_\_\_\_  
 26 <sup>8</sup> See also Restatement (Third) of Restitution and Unjust Enrichment § 51(5)(b) (2011) (“A  
 27 conscious wrongdoer or a defaulting fiduciary who makes unauthorized investments of the  
 28 claimant’s assets is accountable for profits and liable for losses.”).

<sup>9</sup> See Restatement (Third) of Restitution § 51, illus. 24 (victim’s choice may “be made *after* the  
 value of [the property subject to a constructive trust] has been determined”) (emphasis added).

1 Progresso has distinct rights and remedies against distinct defendants: a claim for money damages  
 2 for breach of contract against FB Management (now reduced to judgment), and equitable claims  
 3 concerning the misappropriated property in the hands of Clear Sailing (and the appreciation  
 4 thereon). Neither *res judicata*, election of remedies, nor any other legal or equitable doctrine  
 5 identified by the SRA Investors requires otherwise. *See* Progresso Reply, D.E. 372 at 7-11.<sup>10</sup>

6 At the July 16 hearing, the Court questioned whether Progresso’s right to choose its remedy  
 7 survived the transfer of its funds from FB Management to Clear Sailing. D.E. 380 at 11-16. But the  
 8 fact that a third party—other than a bona fide purchaser for value—holds misappropriated property  
 9 does not defeat the plaintiff’s right to seek either remedy, including profits. “At common law,  
 10 where property has been obtained by fraud, a court in equity ‘has jurisdiction to reach the property  
 11 either in the hands of the original wrong-doer, or in the hands of any subsequent holder’ and to  
 12 convey that property to ‘the one who is truly and equitably entitled to the same.’” *FTC v. Network*  
 13 *Servs. Depot, Inc.*, 617 F.3d 1127, 1142 (9th Cir. 2010).<sup>11</sup> Thus, Progresso’s entitlement to  
 14 appreciation on unauthorized investment follows its misappropriated funds to Clear Sailing under  
 15 any number of equitable doctrines.<sup>12</sup>

16 Finally, the SRA Investors say that Progresso should be deprived of its choice because the  
 17 claims of other innocent parties are involved. But the SRA Investors, although also victims of a  
 18 fraud, have no special entitlement to the appreciation on the Palantir shares bought with Progresso’s  
 19 misappropriated money. To the contrary, if they are permitted to take all that appreciation, while

20 \_\_\_\_\_  
 21 <sup>10</sup> *See also, e.g., In re Wyatt*, 6 B.R. 947, 951-52 (E.D.N.Y. Bankr. 1980) (plaintiff entitled to  
 22 constructive trust remedy did not waive it by obtaining money judgment that had not been  
 recovered).

23 <sup>11</sup> *See also SEC v. Colello*, 139 F.3d 674, 676 (9th Cir. 1998) (the “equitable powers of the federal  
 24 courts can be employed to recover ill-gotten gains for the benefit of the victims of wrongdoing,  
 whether held by the original wrongdoer or by one who has received the proceeds after the wrong”).

25 <sup>12</sup> **Restitution:** *Harris Tr. & Sav. Bank v. Salomon Smith Barney, Inc.*, 530 U.S. 238, 251 (2000)  
 (the fact “that a transferee was not ‘the original wrongdoer’ does not insulate him from liability for  
 26 restitution”). **Constructive trust:** *Moore v. Crawford*, 130 U.S. 122, 128 (1889) (“[A] court of  
 27 equity has jurisdiction to reach the property either in the hands of the original wrongdoer, or in the  
 hands of any subsequent holder, until a purchaser of it in good faith and without notice acquires a  
 higher right and takes the property relieved from the trust.”). **Disgorgement:** *SEC v. Wencke*, 783  
 28 F.2d 829 (9th Cir. 1986) (affirming order requiring disgorgement of profits from wrongdoer’s  
 subsequent transferee); *SEC v. Vassallo*, 2011 WL 3875640, at \*4 (E.D. Cal. Sept. 1, 2011) (same).

1 Progresso takes none, then the SRA Investors will have benefited from the fraud perpetrated against  
 2 Progresso, absent which there would be no (or far fewer) Palantir shares. That’s not equity. *See In*  
 3 *re N. Am. Coin & Currency, Ltd.*, 767 F.2d 1573, 1575-76 (9th Cir.), *amended*, 774 F.2d 1390 (9th  
 4 Cir. 1985) (“[C]reditors should not benefit from fraud at the expense of those who have been  
 5 defrauded.”) (citations omitted).

6 In any event, there is no compelling reason why Progresso’s claim should be diminished  
 7 simply because Clear Sailing was put in receivership. *See Codwise*, 1812 WL 976, at \*9 (finding  
 8 “no possible reason why a fraudulent and void conveyance should interfere with a subsequent  
 9 judgment for a . . . debt against a person afterwards a bankrupt”). Even in the insolvency context,  
 10 “the innocent party can choose either to enforce a lien on [traceable] property for the value of the  
 11 [misappropriated] funds or to enforce a constructive trust on the property,” which, as shown,  
 12 includes the ability to claim appreciation. *Provencher v. Berman*, 699 F.2d 568, 570 (1st Cir.  
 13 1983). Allowing Progresso to choose investor treatment, and the corresponding ability to share in  
 14 the profits of the unauthorized Palantir investment, would not harm the SRA Investors. Instead, it  
 15 would merely allow Progresso to participate in the pro rata distribution of its property and any  
 16 profits thereon, and thus give it no unfair advantage over other similarly situated claimants.

17 Progresso has independently viable investor and creditor claims, and no one has shown  
 18 otherwise. If the Court nevertheless concludes that Progresso is not entitled to choose between  
 19 them, but is limited to creditor status, then it should at least give Progresso the full benefit of that  
 20 status by recognizing its prioritized equitable lien in the full value of its judgment.

21 Dated: July 24, 2018

22 VALLE MAKOFF LLP  
 23 HOLWELL SHUSTER & GOLDBERG LLP

24 By: /s/ Avi B. Israeli

25 Avi B. Israeli  
 26 Attorneys for Interested Party  
 27 Progresso Ventures, LLC